

plagued by comparably serious defects.<sup>76</sup> Under these circumstances, one cannot reach any reliable conclusion regarding the overall “degree of error” in any RBOC’s property records based on these audits. Consequently, these audits cannot and should not serve as a basis for any further corrective action.<sup>77</sup>

The problems with these audits are described in detail in the SBC LECs’ and other RBOCs’ responses, but a few highlights will help show why the audit reports are so unreliable that they do not provide any justification for corrective action.

Because of deficiencies in the sample design and statistical methods, the audit reports provide extremely broad and imprecise estimates of the dollar values of allegedly “not found” equipment. For example, assuming the auditors correctly scored the “not found” items (which they did not), the audit reports reflect that the dollar value of the SBC LECs’ “not found” equipment is  $\$499.1 \pm 216.5$  million for Pacific Bell and  $\$221.7$  million  $\pm 116.4$  million for SWBT, that is, somewhere between  $\$282.6$  million and  $\$715.6$  million for Pacific Bell and between  $\$105.3$  million and  $\$338.1$  million for SWBT.<sup>78</sup> This represents spreads of  $\$433$  million and  $\$232$  million which are 87% and 105% of the midpoint of their respective ranges. Such estimates in the other RBOCs’ audit reports were similarly imprecise.<sup>79</sup> The huge margin of error in dollar estimates is

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<sup>76</sup> See, e.g. US WEST Response at 14-20.

<sup>77</sup> The SBC LECs’ Comments on Issue 3 do not address undetailed investment because that subject is considered separately in Issue 5.

<sup>78</sup> SWBT Reports at 15; Pacific Report, Appendix B, at 15.

<sup>79</sup> See, e.g., BellSouth Response at 2.

only one of the problems with the auditors' statistical procedures. However, considering the problems with the auditors' methods of scoring and rescoreing the field audit results, one must conclude that the audit results are extremely unreliable, even as they relate only to the degree of compliance with the CPR requirements. For example, while the auditors ultimately concluded that 198 out of the 2,304 items in the SBC LECs' sample were not "not found," the SBC LECs furnished proof that this number should have been reduced to 106, or 4.6% of the selected items in the sample, if not lower.<sup>80</sup> On an investment basis, these 106 items represent about 3% of the total investment in the sampled items. Thus, in effect, the SBC LECs were able to show that 97% or more of their sampled investment was found. And, if the SBC LECs had known the secret standards of proof being applied by the auditors, they would have been able to submit even more evidence to show the existence of additional items. When the auditors' estimates of the wide range of values for "not found" items are adjusted using the corrected scores for "not found" items based on the rescoreing evidence submitted by the SBC LECs, the low end of the range approaches zero, and, if a conservative 99% confidence interval is used, the low end dips below zero.<sup>81</sup> Other RBOCs had a similar experience with the auditors' scoring and rescoreing methods. The auditors simply refused to accept the vast majority of the RBOCs' evidence or to explain their reasons for rejecting that evidence.<sup>82</sup>

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<sup>80</sup> See SBC LECs Response at 23 n. 47.

<sup>81</sup> See EY Pacific Report at 21.

<sup>82</sup> See, e.g., US WEST Response at 11-15 (US WEST found 78% of the items the auditors classified as "not found").

Not only did the auditors reject the RBOCs' rescoring evidence without explanation, they also refused to consider other evidence and information presented by the RBOCs. For example, the SBC LECs presented information concerning the performance and results of its SAVR inventory process, but the auditors summarily dismissed it, reasoning simply that it "was not accompanied by documentation."<sup>83</sup> As part of the SAVR process, initiated in early 1997, the SBC LECs hired independent contractors to perform a two-way physical verification or inventory of 100% of their central office hardwire investment. Thus, the SAVR process is extremely relevant to this audit in a number of respects, including the fact that, in conducting those SAVR inventories, the SBC LECs have been able to eliminate most of the undetailed investment. These results demonstrate that thorough review of the SBC LECs' hardwire inventory will verify its existence. The SBC LECs have offered to provide a detailed review of the SAVR process and its advantages to the auditors, but the auditors have chosen to ignore the SAVR process and results in their analysis.<sup>84</sup> The auditors should have reviewed the SAVR process as part of their procedures.

The auditors also apparently chose to ignore or downplay the significance of information regarding the RBOCs' internal practices, procedures and controls, such as

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<sup>83</sup> SWBT Report at 14 n. 40.

<sup>84</sup> The auditors' refusal to consider SAVR stands in stark contrast to the auditors' willingness to consider GTE's efforts to enhance its inventory procedure using a bar-coding process. *GTE Telephone Operating Companies; Release of Information Obtained During Joint Audit*, 13 FCC Rcd 9179, Audit Report at 3, 7 (1998).

Bell Atlantic's evidence of "separate safeguards [that] ensure that investment balances are tied to actual payments."<sup>85</sup>

When one considers these and the other deficiencies in the audit procedures, it is clear that the audit results cannot properly support any further corrective action. While the SBC LECs cannot claim that their property records are perfect, the SBC LECs are confident that they are substantially in compliance with the FCC's burdensome and unnecessary CPR requirements and that their books accurately reflect the investment in hardwired equipment.

Because the FCC requires ILECs to maintain CPRs in excessive and unnecessary detail, the likelihood of error is higher than it would be otherwise.<sup>86</sup> Under the current procedures, any changes to level of detail (i.e., property record unit definition) in the CPR must be submitted to the FCC for approval which gives the FCC the power to deny or delay any simplification of the CPR detail – as the FCC has done in the case of SWBT.<sup>87</sup> A typical large ILEC is required to keep track of as many as 30 to 50 million units overall in its CPRs. And, in the case of the hardwire CPRs, a large ILEC must keep track of several million units, regardless of their individual value. This CPR process was designed and made more onerous at a time when the large ILECs were subject to cost-

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<sup>85</sup> Bell Atlantic Response at 14 and Exhibit 4.

<sup>86</sup> US WEST Response at 5.

<sup>87</sup> Two of SWBT's requests for simplification of the hardwire property records were denied in 1996. Letter dated July 10, 1996 from Kenneth P. Moran, Chief, Accounting and Audits Division, FCC, to Jane Knox, Director—Federal Regulatory, SBC; Letter dated Dec. 26, 1996 from Kenneth M. Ackerman, Chief, Accounting Systems Branch, FCC to Jane Knox, Director—Federal Regulatory, SBC.

based, rate-of-return regulation and rates were directly tied to the amount of investment. It would be unreasonable and unrealistic to insist that ILECs maintain absolutely perfect records of their property in view of the extremely onerous nature of these CPR requirements and the lack of importance of these requirements in regulating price cap ILECs.<sup>88</sup> Especially considering these circumstances and the deregulatory mandate of the 1996 Act(e.g., to review and streamline its rules), the FCC must have some reasonable standard of materiality for evaluating an ILEC's compliance with the CPR requirements other than perfection or near-perfection.<sup>89</sup>

On top of the excessive level of detail that the rules themselves require, the auditors used an unrealistically narrow and unprecedented interpretation of the rules in conducting these audits. An item that is found within the four walls of the central office location shown in the CPR should be deemed to comply with the CPR requirements. And yet, the auditors did not give the SBC LECs credit for certain items found in a different bay or shelf than that shown in the CPR even though the items were found within the four walls of the same central office location.<sup>90</sup> Also, items considered "found" should not be limited to those that can be found in an unreasonably short amount of time such as the ten to twenty minutes typically permitted by the auditors' procedure

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<sup>88</sup> Even the federal government does not require accurate asset tracking for its own agencies, as the GAO's 1997 audit report for the federal government reflects. *See* GAO, Report to the Congress, Financial Audit: 1997 Consolidated Financial Statements of the United States Government.

<sup>89</sup> *See* SBC LECs Response at 50-51; BellSouth Response at 8; US WEST at 5-6, 16-17.

<sup>90</sup> *See also* Ameritech at 7; GTE's Motion for a Declaratory Ruling on Asset Verification, filed May 13, 1998.

in this audit, and without having sufficient opportunity to locate supporting documents before the auditors reach their steadfast conclusions.

The degree of error in the CPR records is not material, especially when it is measured in terms of the low end of the range of dollar values of the estimate of "not found" items using the corrected scores for "not found" items furnished in the RBOCs' responses and stated in terms of net, rather than gross, book values. Even in terms of the quantity of "not found" items, the SBC LECs have shown that, on an investment basis, 3% or less of the 2,304 sampled items are properly in the "not found" category, based on the evidence submitted. And, this should be deemed sufficient to comply with the CPR requirements in view of their excessive level of detail and the low value items that must be tracked.

While the audit reports claim that items other than those that were "not found" are seriously deficient and "apparent violations" of the rules, these technical errors are, by definition, not material to any FCC regulatory process. Besides, it is not at all clear that these technical errors in the CPR records are violations of the FCC rules, given that the records contain a number of details not expressly required by the rules.

For these reasons, the immaterial degree of error in the CPR records is clearly not sufficient to require any corrective action.

**IV. The Auditors' Recommended Write-Off Is Unjustified, Contrary to the Rules and Otherwise Improper (Issue 4).**

In addressing Issue 3 above, the SBC LECs have already shown that the degree of error in the CPRs is immaterial and does not justify any corrective action. Issue 4 simply

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inquires about one form of corrective action, an accounting adjustment based on "missing" plant. Certainly, the same reasoning applies to accounting adjustments as to corrective action generally. Thus, the audit results do not provide any justification for requiring any accounting adjustments for the same reasons discussed under Issue 3 above. Because of the many flaws in these audits discussed above and in the responses, they provide no rational basis for any type of accounting adjustment.<sup>91</sup>

The audit reports recommend summarily writing off the auditors' estimate of the cost of "not found" items and undetailed investment. While Issue 4 does not specifically ask for comment on this recommendation, it is the main accounting adjustment recommended by the auditors. As the SBC LECs explained in their Response, this recommendation has a number of serious flaws.<sup>92</sup> The other RBOCs agree that this recommendation is seriously flawed.<sup>93</sup>

Like the other recommendations, this one is based on the premise that the auditors have proven that there is a material amount of "missing" plant. However, the audit reports "prove[ ] nothing of the kind."<sup>94</sup> The flawed audit methodology and procedures produce highly questionable results that cannot serve as the basis for any such write-off on the RBOCs' regulated books of account. There is simply no statistically valid basis to conclude that the RBOCs' books are overstated by hundreds of millions of dollars, as the auditors conclude. In fact, as noted above, in the SBC LECs' case, the low end of the

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<sup>91</sup> In fact, according to EY, it would be inappropriate for the SBC LECs to make any financial adjustments based on the FCC's audit. SBC LECs Response, Attachment D.

<sup>92</sup> SBC LECs Response at 6-8.

<sup>93</sup> Ameritech Response at 17; Bell Atlantic Response at 23-24; BellSouth Response at 7, 32; US WEST Response at 26.

<sup>94</sup> Bell Atlantic Response at 23.

99% confidence interval for dollar values using the corrected data for “not found” items is well below zero.

Another problem with the recommended write-off is that it is contrary to the FCC’s own accounting rules, as most of the RBOCs explained in their responses.<sup>95</sup> For example, Section 32.2000(d)(1)<sup>96</sup> requires all retirements to refer to the specific records in the CPR from which the retired cost was taken. However, in disregard of this requirement, the auditors recommend writing off an extrapolated amount based on their statistical analysis. Thus, the auditors apparently intend for the RBOCs to adjust their Part 32 books now, but leave the CPRs unchanged until after completion of the recommended inventory of all of their central office equipment. Making such an accounting adjustment would create a major out-of-balance situation between the detailed CPR (PICS/DCPR) and the books of account, contrary to the FCC’s rules. Making this write-off adjustment without any tie-in to individual CPR records will render the CPR useless as a method of detailing the dollar value of equipment on the books. Further, as Bell Atlantic explains, this write-off “would make it impossible to do an annual reconciliation and to balance the two measures as is required under Commission rules. *See* 47 C.F.R. § 32.2000 (e)(2)(iii).”<sup>97</sup>

There is also a logical inconsistency in the auditors’ recommendations. On the one hand, they recommend summarily writing off the estimated amounts and yet they

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<sup>95</sup> *See* Ameritech Response at 17; Bell Atlantic Response at 23-24; BellSouth Response at 32 n.77; SBC LECs Response at 7.

<sup>96</sup> 47 C.F.R. § 32.20000(d)(1).

<sup>97</sup> Bell Atlantic Response at 24. Bell Atlantic explains that this recommendation is also contrary to the requirements for an extraordinary retirement, which is what the auditors are, in effect, recommending. The SBC LECs agree that the conditions for an extraordinary retirements in § 32.2000 (g)(4) are not satisfied. For further discussion of this rule, see section VIII(B) below.



state that "the only way to ensure a CPR line-item is correct is to examine the corresponding equipment items. The only way to validate all of the line-items is to conduct an inventory of the entire CPR."<sup>98</sup>

There is a similar lack of consistency in the auditors' jumping to the conclusion that the entire balance of the undetailed investment should be completely written off while claiming that an inventory of the entire CPR would be an effective means of confirming that SWBT has reduced its undetailed investment.<sup>99</sup>

Further, the auditors' recommendation does not consider all of the changes in the books of account and in the CPRs that have occurred since the sample was pulled two and a half years ago. For example, some of the RBOCs describe their own physical inventory procedures, which would have resulted in changes to the records.<sup>100</sup> Likewise, routine construction and replacement activities have already changed the records. In some cases, such as the SBC LECs, the changes have been dramatic. The SBC LECs' SAVR inventory process, which is already correcting any inaccuracies in each central office, has contributed to a substantial amount of change in the records. The auditors' recommended write-off does not take into consideration the significant record changes resulting from the SAVR inventory process. For example, the auditors recommend that SWBT write off \$924 million of investment that was listed as undetailed in the CPR as of June 1997, but, as a result of the SAVR inventory process, this undetailed investment has been reduced to about \$100 million currently.<sup>101</sup> Obviously, it would be impossible to

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<sup>98</sup> Pacific Audit Report at 17, ¶38.

<sup>99</sup> SWBT Audit Report at 18 n.51.

<sup>100</sup> See, e.g., BellSouth Response at 6, 30-31.

<sup>101</sup> SBC LECs Response at 19-20.

write off \$924 million when only \$100 million remains as undetailed. In any event, a write-off is the wrong approach, as the SAVR inventory process further demonstrates. Once it is completed, the SAVR process will have identified and detailed or retired all of SWBT's remaining undetailed investment in hardwire central office equipment – despite the fact that it is permissible for the RBOCs to have undetailed investment for periods pre-dating implementation of the mechanized CPR designed by AT&T.<sup>102</sup> In all probability, the other RBOCs' records also experienced changes during the last two years. For instance, BellSouth's eight-year inventory cycle, combined with other special inventory programs, would have made inventory adjustments for over one-fourth of its locations.<sup>103</sup>

An inventory process such as SAVR or the periodic inventories described by BellSouth and Bell Atlantic<sup>104</sup> represent a much better approach than a summary write-off of an extrapolated figure – even if the auditors were able to perform a statistically valid inventory process. However, as discussed under Issue 6 below, this does not mean that these audit results justify requiring the RBOCs to conduct any additional inventories because they certainly do not.

The auditors write-off recommendation raises concerns similar to those expressed by AT&T in challenging the FCC's USOA before the United States Supreme Court.<sup>105</sup> AT&T was concerned that the operation of the USOA might require certain accounts to be summarily written off. Resolving AT&T's concern, the FCC assured the Court

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<sup>102</sup> See SBC LECs Response at 34-46. For further details, see the discussion under Issue 5 below.

<sup>103</sup> BellSouth Response at 6, 30-31.

<sup>104</sup> BellSouth at 30-31; Bell Atlantic at 24.

<sup>105</sup> Brief for Appellants, AT&T *et al.*, *AT&T v. United States*, No. 97, filed Oct. 29, 1936, at 3, 21-24.

that amounts included in account 100.4 that are deemed, after a fair consideration of all the circumstances, to represent an investment which the accounting company has made in assets of continuing value will be retained in that account until such assets cease to exist or are retired . . .<sup>106</sup>

The Court “accepted this declaration as an administrative construction binding upon the Commission in its future dealings with the companies”<sup>107</sup> and explained that “only such amount will be written off as appears, upon application of appropriate directions, to be a fictitious or paper increments.”<sup>108</sup> Thus, write-offs as substantial as those recommended by the auditors should not be required without a fair consideration of all the circumstances.<sup>109</sup>

In any event, the auditors’ write-off recommendation is contrary to the evidence which shows among other things, that the RBOCs were able to find items deemed “not found” by the auditors, that the auditors’ estimates of dollar values are highly inaccurate and unreliable, that a conservative low-end figure for the estimate would be close to or below zero, and that any remaining inaccuracies in the CPR are immaterial, and in any event, are being corrected in the ordinary course of existing inventory procedures.<sup>110</sup>

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<sup>106</sup> *AT&T v. United States*, 299 U.S. 232, 241 (1936).

<sup>107</sup> *Id.*

<sup>108</sup> *Id.*

<sup>109</sup> *See United States v. New York Tel. Co.*, 326 U.S. 638, 652-55 (1946).

<sup>110</sup> Further, we cannot safely assume that an inaccuracy in the CPR necessarily means an error in the account balances in all cases. As Bell Atlantic points out, there are separate practices, controls and procedures the auditors failed to consider that assure that the investment on the books is accurate and is tied to actual payments and costs incurred. Bell Atlantic Response at 13-14 & Exhibit 4.

**V. Undetailed Investment Has Been Allowed by the FCC for 30 Years (Issue 5).**

The FCC should reject the auditors' recommendation that the RBOCs write off all of their "undetailed investment." The vast majority of the undetailed exists in the mechanized CPR, known as PICS/DCPR, because it represents equipment that was placed in service before each RBOC implemented the mechanized CPR in a particular state or region.<sup>111</sup> In a December 1968 ruling, the FCC approved this method of implementing the mechanized CPR for hardwire equipment "on a going-forward basis" that is, for plant added after the start of the plan in each region.<sup>112</sup> Requiring a write-off of this undetailed investment would be contrary to the FCC's December 1968 ruling and the long history of the FCC's knowledge of the undetailed investment, as described in detail in the SBC LECs' Response.<sup>113</sup>

Not only did the FCC consider the undetailed investment to be permissible, but the December 1968 ruling required the RBOCs to notify the FCC before detailing any equipment installed prior to the effective date of the mechanized CPR. The FCC has permitted this category of investment to exist in PICS/DCPR for over thirty years and it would be an arbitrary reversal of position to suddenly require it to be written off, regardless of whether it continues to represent equipment that is used and useful in the provision of regulated services.

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<sup>111</sup> The mechanized CPR, or PICS/DCPR, was implemented in different years across the Bell System, beginning in 1968 in California and ending in SWBT's five-state territory in 1983. *See* SBC LECs Response at 34-38.

<sup>112</sup> Letter dated Dec. 24, 1968 from Kelley E. Griffith, Chief, Domestic Rates Division, FCC, to Alexander L. Stott, Vice President and Comptroller, AT&T ("Dec. 1968 Ruling") (citing AT&T Comptroller's Letter M-295, "Outline of Plan for a Mechanized Detailed Property Record of Central Office Equipment," May 1968, § 1.07).

<sup>113</sup> SBC LECs Response at 34-46.

Ameritech explains the apparent reason for AT&T's decision approved in the FCC's December 1968 ruling, to implement the mechanized CPR on a going-forward basis: "This implementation included the determination not to detail the embedded hardwired equipment as a cost benefit consideration because it was too expensive."<sup>114</sup> Obviously, compiling all of the details for the pre-existing equipment would have been a monumental task. For example, when SWBT implemented PICS/DCPR in 1983, practically all of its hardwire investment, which totaled more than six billion dollars<sup>115</sup> of equipment, was undetailed. It would have required an extraordinarily costly effort to compile details for this embedded base of equipment in PICS/DCPR. Thus, AT&T's approach to the undetailed was eminently sensible and efficient. Over time, as the older equipment was replaced, such as through analog to digital conversions, the amount of undetailed in the mechanized CPR would shrink through attrition. In fact, over time, the undetailed was dramatically reduced. For example, SWBT's \$6 billion (approx.) of undetailed investment in 1983 was reduced to about \$4.5 billion in 1985, \$1.5 billion in 1994, \$924 million in 1997 and just over \$100 million as of year-end 1998.<sup>116</sup>

Just as the FCC applied cost/benefit considerations in permitting AT&T to implement PICS/DCPR on a going-forward basis in the Bell System, the FCC's current approach to the undetailed should weigh the costs against the benefits of any action. A write-off would clearly be improper in light of the December 1968 ruling. But neither should the FCC require the RBOCs to compile details for the undetailed investment in

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<sup>114</sup> See also Ameritech Response at 9.

<sup>115</sup> This is an approximate figure just prior to divestiture at the end of 1983.

<sup>116</sup> SBC LECs Response at 19-20; cf. Ameritech Response at 9-10 (also noting significant reduction in undetailed investment over time).

view of the unreasonable expense of conducting inventory and records searches when the benefits of this activity are uncertain.<sup>117</sup>

The FCC should not impose onerous requirements to address the undetailed investment; instead, it should recognize efforts such as those of the SBC LECs in systematically identifying and eliminating the undetailed investment via the SAVR inventory process initiated in early 1997. The results of these efforts are described in the SBC LECs' Response.<sup>118</sup> However, the auditors summarily dismissed the SAVR efforts, as explained earlier in these Comments.<sup>119</sup> While the SBC LECs were not required to include the undetailed investment in their SAVR inventory program, they voluntarily agreed to do so. And, the results of these efforts have rendered the auditors' recommendation largely moot: in SWBT's case, the auditors recommend writing off \$924 million of undetailed investment, but barely over \$100 million remained as of year end 1998.<sup>120</sup> And yet, the auditors chose to ignore this information almost entirely in finalizing their audit report by continuing to insist that the full \$924 million be written off.

The only, seemingly reluctant, recognition of this dramatic reduction of SWBT's undetailed investment is in the following footnote added to the final draft of the audit report:

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<sup>117</sup> In the 1994 audit of Pacific Bell, the FCC auditors used a more reasonable approach than the auditors now recommend. Rather than recommending a complete write off, the auditors stated that Pacific Bell "should establish procedures to detail the undetailed investment and provide the Commission with those procedures and the amount of time required to implement them." Letter dated April 11, 1994 from Jose Rodriguez, Chief, Audits Branch, FCC to Sheryl L. Herauf, Pacific Telesis at 5.

<sup>118</sup> SBC LECs' Response at 18-20.

<sup>119</sup> See discussion under Issue 3 above.

<sup>120</sup> See SBC LECs Response at 3, 19.

Audit by an independent firm will also be an effective means of following up on and confirming SWBT's reduction of SWBT's Undetailed Investment subsequent to our on-site audit work as discussed *supra* in fn. [40]<sup>121</sup>

It is unclear how the auditors can conclude that \$924 million should be written off when they have not even considered such a significant subject that it acknowledges to have a bearing on its conclusion.<sup>122</sup> Apparently, the auditors did not even understand that the SAVR process that reduced SWBT's undetailed investment is itself a complete asset verification; otherwise, one would expect them to explain why one multimillion dollar inventory process is necessary to confirm the results of another such process. Clearly, the auditors ignored this evidential matter just as they summarily wrote off other information that might hurt their case.<sup>123</sup>

**VI. Complete Physical Inventories Are Not Justified by the Audits or on a Cost/Benefit Basis (Issue 6).**

Just as these CPR audits do not provide any justification for any corrective action, or for the auditors' recommendation to require write-offs for missing and undetailed equipment, they also should not be used as a basis to require any of the RBOCs to incur substantial, additional costs to inventory all of their central office equipment, as the audit reports also recommend. The numerous problems with the audits described under issues 1 through 3 above make them completely unreliable, even as a basis to require the RBOCs to conduct inventories of all of their central office equipment. Besides, the

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<sup>121</sup> SWBT Audit Report at 18 n.51.

<sup>122</sup> *Cf.* BellSouth at 25 (describing how auditors prejudge unallocated other costs as deficient even though they have deferred completing investigation of that subject).

<sup>123</sup> The auditors similarly ignored Ameritech's proof of the existence of the undetailed investment. *Compare* Ameritech Response at 10 & Appendix "D" with Ameritech Audit Report at 12-13.

auditors' recommended comprehensive inventories would duplicate efforts such as the SAVR inventory process and the other RBOCs' rotating inventory procedures.

In addition, the SBC LECs agree with Ameritech's observation that "[s]uch an undertaking is not justified on a cost benefit basis. . . This expenditure would be wasted because neither ratepayers nor shareholders would receive any benefit."<sup>124</sup> In the current regulatory and competitive environment, the FCC needs to consider the tremendous costs and the minimal, if any, benefits of performing comprehensive audits in the level of detail of the current CPR requirements.

Ameritech estimates that such an inventory of its equipment would take 700,000 hours and cost over \$35 million. Bell Atlantic estimates that such an inventory would cost between \$50 and \$100 million. The SBC LECs estimate that to retain an independent firm to conduct a comprehensive inventory of all of their central offices would cost between \$30 and \$45 million in external costs alone.<sup>125</sup> Based on these estimates, the identifiable costs of all of these audits could be as much as \$250 million for all of the RBOCs, and this estimate does not consider all of the internal costs and the substantial disruption of the business.

On the other side of the balance, the benefits of requiring a complete physical inventory of all central office equipment are minimal or nonexistent. As explained under Issues 8 and 9 below, under price cap regulation, failure to record retirements discovered

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<sup>124</sup> Ameritech Response at 18.

<sup>125</sup> This estimate assumes that the entire inventory process is turned over to an independent firm or auditor. The RBOCs' existing inventory programs represent a more cost-effective approach, in that most, if not all, of the work is performed by their existing internal staffs and the costs are spread out over multiple years. For example, the SBC LECs have been using such a cost-effective approach in performing the SAVR inventory process.



in any physical inventory would neither benefit nor harm ratepayers or others. In an era when the FCC supposedly has severed the relationship between accounting cost data and rates and is attempting to reduce the burden of unnecessary or burdensome accounting and reporting regulation, it does not make sense to impose new rate-of-return style requirements such as physical inventories. This is especially true given that the FCC never undertook inventories of this nature during the decades of rate-of-return regulation.

The RBOCs' existing internal controls and procedures should be considered reasonable and sufficient to safeguard assets, assure accurate financial accounting and reporting and otherwise satisfy reasonable accounting requirements. Some of the RBOCs describe inventories on a rotational basis over a period of years. For example, BellSouth performs physical inventories of all central offices over a period of eight years. Bell Atlantic likewise performs inventories in a cost-efficient manner over a number of years. An additional comprehensive inventory by an independent firm, as recommended by the auditors, would be redundant and costly and with no greater benefit than the SAVR inventories and the other RBOCs' cyclical inventories already produce. In effect, requiring additional comprehensive inventories would not accomplish anything of value to anyone.

The SBC LECs also have adequate internal controls and they have undertaken efforts to further enhance those controls. A significant example of these efforts is the SAVR inventory process that the SBC LECs planned in 1996 and initiated in early 1997. Upon completion of the SAVR inventory process, an inventory of all of the SBC LECs'

hardwire assets will be complete. Pacific Bell has already completed the SAVR process in all of its central offices. In effect, the SBC LECs had already independently implemented an inventory process that is equivalent to the FCC auditors' recommended inventories, although the SAVR inventories were performed in a more cost-effective fashion than turning the entire inventory process over to an independent firm. The SAVR process uses independent contractors to perform on-site inventories of all of the SBC LECs' central offices, as the auditors recommend. However, the SBC LECs retain overall control of the inventory process using cost-effective procedures. A more detailed description of the SAVR inventory process is attached as Exhibit "C". As this description indicates, the SAVR inventory process updates the records based on a comprehensive, two-way review of all hardwire equipment in each central office.

Therefore, in the case of the SBC LECs, the auditors' recommended inventories are totally uncalled for, as they would duplicate a process that has been in progress for the last two years. And, the SBC LECs have shown that their own inventory process has been extremely effective, as reflected in results such as the detailing of the undetailed investment discussed above under Issue 5.

**VII. Any Independent Review of Internal Controls Should Include a Review of Methods of Streamlining and Updating the FCC's Asset Tracking Requirements (Issue 7).**

According to the NOI, the purpose of the auditors' third recommendation, i.e., to require the RBOCs to engage independent auditors to review their procedures and controls for maintaining CPRs, is "to improve the likelihood that the CPRs will be

maintained correctly in the future.”<sup>126</sup> This recommendation appears to assume that the RBOCs have maintained their CPRs incorrectly in the past. However, based on the discussion of the preceeding issues, the SBC LECs submit that they are substantially in compliance with the CPR requirements, and thus, there is no justification for requiring them to engage an independent auditor to perform a review of their internal procedures and controls.

In fact, the auditors did not even perform a thorough review of procedures and controls as part of their audit. One of the basic principles of the Generally Accepted Auditing Standards (“GAAS”) is that “[t]here is to be a proper study and evaluation of the existing internal control . . . .”<sup>127</sup> As some of the RBOCs observed in their responses, the auditors here did not undertake an adequate review of internal controls.<sup>128</sup> For example, Bell Atlantic’s Response includes a report from PriceWaterhouseCoopers on its review of the internal controls for booking hardwire equipment in the general ledger,<sup>129</sup> which the FCC auditors did not consider. The FCC auditors did not even obtain a sufficient understanding of the SBC LECs’ internal controls for its CPR before conducting the field audits. Further, the auditors refused to consider one of the SBC LECs’ significant internal procedures, their SAVR inventory process, which will

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<sup>126</sup> NOI at 4.

<sup>127</sup> AICPA Professional Standards, GAAS, AU §150.02 (June 1988) (Standards of Fieldwork). *See also* Comptroller General of the United States, Government Auditing Standards (the “Yellow Book”), June 1994, ¶¶ 4.2(b), 4.21 & 4.27.

<sup>128</sup> *See, e.g.*, US WEST at 9 and Attachment 1.

<sup>129</sup> Bell Atlantic at 13-14 and Exhibit 4.

complete an inventory of 100% of the SBC LECs' hardwire equipment. The SAVR process has enhanced the SBC LECs' CPRs, for instance by detailing the undetailed investment. The SAVR process also has provided the means to identify areas for potential enhancements in the SBC LECs' internal controls. The SBC LECs have invited the FCC auditors to review their SAVR process and have offered to provide them a detailed walk-through of the SAVR process.<sup>130</sup> An overview of the SAVR inventory process is provided in Exhibit "C" to these Comments. While the auditors have had every opportunity to review and evaluate the SAVR process, they have failed to do so. Instead, they have rejected some of the most significant SAVR results by claiming that the results were not "accompanied by documentation."<sup>131</sup> The auditors never even bothered to review the SAVR process or its documentation. Given that the auditors did not thoroughly review the RBOCs' internal controls or fully consider them in designing their audit or reporting their results, it is hard to see how they have any basis to recommend an independent audit of those controls.

While an independent audit of internal controls and procedures is not justified on the basis of the audits alone, the SBC LECs are willing to consider reasonable, cost-effective methods of enhancing their internal controls, provided there is some material benefit in doing so. However, as discussed under Issue 3 above, there is no benefit in requiring carriers to continue tracking network assets on an excessively detailed basis,

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<sup>130</sup> See, e.g., Letter dated Dec. 16, 1998 from B. Jeannie Fry, Director—Federal Regulatory, SBC to Ken Moran, Chief, Accounting Safeguards Division, FCC. See also SBC LECs Response at 8-9.

<sup>131</sup> SWBT Audit Report at 14 n.40.

without regard to the value of individual units or the materiality of the data being tracked. Simply stated, the CPR requirements are wasteful and outdated. They are outdated because of the vast changes in technology and procurement practices. For example, carriers now order in modules rather than piece parts, but the FCC still requires individual tracking of the piece parts.<sup>132</sup> Further, these requirements are wasteful because carriers, their customers and taxpayers are overburdened with the cost of compliance and auditing of these excessive CPR requirements without any benefit for the consumer. As

US WEST observes, these requirements are designed in a fashion that increases the likelihood of error. The FCC itself appears uncertain as to whether these audits have served any useful purpose, as it is seeking comment from interested parties concerning the impact, rather than affirmatively alleging that there is an impact. And yet, the FCC acknowledges that significant FCC resources were devoted to these audits, including 4,800 hours of staff time per audit, and \$174,500 in wages and out-of-pocket expenses per audit. If the benefits of the audit are so uncertain, it is unclear why such significant public resources were devoted to this effort. Under rate-of-return regulation such an audit would have made more sense, as in the case of a similar Michigan audit 20 years ago,<sup>133</sup> but in the current environment where investment levels should have no impact on rates, this sort of audit is a wasteful process. These resources would be better used in implementing the priorities of the 1996 Act, such as universal service, advanced services,

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<sup>132</sup> The FCC, in effect, requires this by denying requests for changes in the level of detail in the companies' CPRs.

<sup>133</sup> *Compliance Audit of Michigan Bell Tel. Co.*, Case No. U-6516, 1982 Mich. PSC LEXIS 939 (June 8, 1982).

and elimination of unnecessary regulation through the Biennial Review process. In view of these concerns regarding the excessive burden of the existing CPR requirements, and provided any review of internal controls is warranted after considering a sample review of the SAVR inventory process, the SBC LECs would be willing to consider engaging the independent auditor that is already familiar with the SBC LECs' internal controls generally, i.e., Ernst & Young, to review the internal procedures and controls as well as the FCC's CPR requirements. The dual purposes of this review would be to recommend (1) methods of streamlining and updating the FCC's CPR requirements and (2) changes and enhancements of the internal procedures and controls to enable the SBC LECs to comply with the streamlined, updated CPR requirements.

Such a review should consider how the CPR requirements should be updated in view of the dramatic changes in technology and the market since they were last reviewed, with a view toward ultimately making a transition to GAAP alone.

The CPR requirements have not kept up with these changes. For example, increasingly, equipment is available in packages or modules that include a number of individual components. For example, the SBC LECs may order a "switch module cabinet" that contains a number of standard hardwire and other components. There is no added value in breaking the module into its numerous components in the property records because it is ordered and delivered and operates as a single unit. The FCC could make it easier to comply with the CPR requirements if tracking were at the higher level of the modules rather than at the individual "fifty dollar" component level. The level of detail required in the CPR could be reduced to require carriers to track modules rather than individual parts without losing the ability to track all the assets. Under such a system, the

assets would be tracked in a more sensible fashion like unregulated businesses, including the SBC LECs' unregulated competitors.<sup>134</sup> The streamlined, efficient CPR requirements would be implemented as a result of such a review during a transition period and, thereafter, the FCC should consider seriously relying on GAAP alone.

In summary, if a review of the internal procedures and controls for maintaining CPRs is warranted at all, it must include a careful evaluation of the FCC's asset tracking requirements if this review is to accomplish anything of value to carriers, their customers and the industry.

**VIII. Under Price Cap Regulation, CPR Audits Should Have No Adverse Impact on Ratepayers (Issue 8).**

**A. Account Balances Are Not Used in Setting Rates Under Price Cap Regulation.**

The audit reports state that accurate account balances are important to policymakers in performing regulatory functions such as ratemaking activities for price cap carriers.<sup>135</sup> Against this background, the auditors suggest that the RBOCs' account balances should be adjusted based on the audit results to avoid an adverse impact on ratepayers. However, as discussed above, the audit results are too unreliable and inaccurate to serve as a basis for any adjustments to the account balances. And, in any event, account balances should no longer play a role in the regulation of price cap carriers' rates.

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<sup>134</sup> See Arthur Andersen L.L.P., "Accounting Simplification in the Telecommunications Industry," filed July 15, 1998 (the "Arthur Andersen Whitepaper").

<sup>135</sup> See, e.g., SWBT Audit Report at 1.

Reflecting some uncertainty, the NOI asks “[w]hat ratepayer impact, if any, the alleged discrepancies may have had.”<sup>136</sup> Even if one assumes that discrepancies in the CPRs could have ratepayer impact under price cap regulation, the impact would have to be insignificant given that the inaccuracies in the CPR are immaterial. The audit reports exaggerate the magnitude of the inaccuracies, ignore the RBOCs’ evidence and reach unreliable and highly inaccurate conclusions. In any event, one cannot safely assume that any relationship exists between CPRs and rates such that inaccurate CPRs could have any impact on ratepayers. The advent of price cap regulation almost ten years ago changed all that. CPRs and account balances have no longer played much, if any, part in the regulation of price cap carriers’ rates. Instead, rates are determined using a formula under which new rates are equal to current rates adjusted by inflation, offset by productivity gains. Thus, any direct tie linking CPR records and rates has been cut.

While the rate-of-return backstop mechanisms of price cap regulation initially retained tenuous, contingent connections between book costs and rates, the elimination of sharing removed the most significant remaining connection and the virtually assured elimination of the low-end adjustment by the recent *Pricing Flexibility Order*<sup>137</sup> will completely sever any remaining indirect ties. And, even from a cost-based, rate-of-return perspective, if the results of these audits required any retirements, they would not have any material impact on net plant balances or prices, as explained in the Declaration of Marla Martin (the “Martin Declaration”) attached as Exhibit “D”.

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<sup>136</sup> NOI at 4 (emphasis added). The Bureau’s responses to questions from Congress reflect the same uncertainty. For example, the Bureau states that “[f]urther proceedings may be required to reach a conclusion” and that “appropriate corrective accounting treatment should be determined after consideration of comments from interested parties.” Feb. 24, 1999 FCC Letter to Congressmen Tauzin and Dingell at 8.

<sup>137</sup> *Access Reform; Price Cap Performance Review for Local Exchange Carriers*, CC Docket Nos. 96-262 & 94-1, *Fifth Report and Order*, FCC 99-206, released Aug. 27, 1999, ¶167 (“*Pricing Flexibility Order*”).



As Bell Atlantic explains, the only connection between the Part 32 account balances and the CPR is that the CPR serves as the basis for retirements.<sup>138</sup> In effect, what the audit results reflect is that certain items have been retired previously but the retirement had not been posted in the CPR at the time of the audit. Thus, these are omitted or delayed retirements. As the Martin Declaration shows, even under rate-of-return regulation, delayed retirements would have very little, if any, impact on ratemaking over time<sup>139</sup> and given that any inaccuracies are much smaller than those estimated in the audit reports, there would be virtually no impact. As explained in the Martin Declaration, the minimal, if any, impact is due to a combination of several factors.<sup>140</sup> First, under group depreciation methods, the retirement of an asset does not have any impact on net plant balances because the original cost is removed from both (1) the plant account and (2) the accumulated depreciation reserve account. Second, remaining life depreciation rates are self-correcting in nature, that is, they reduce depreciation rates to correct for any previous over-depreciation and vice versa. An imbalance in depreciation recovery resulting from a delayed retirement would only be temporary and would be corrected in future remaining life depreciation rates. Third, changes in depreciation produce two separate but related impacts on the revenue requirement that move in opposite directions. If depreciation expense goes up, then depreciation reserve increases but net investment (on which return is calculated) decreases. This serves to mitigate the impact on the revenue requirement of a change in depreciation. Other RBOCs reached the same conclusions in their analyses of the

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<sup>138</sup> Bell Atlantic Response at 14.

<sup>139</sup> Martin Declaration *passim*.

<sup>140</sup> *Id.* at 1-2.

revenue requirement and capital recovery implications of retirements. For example, based on its analysis and a financial model, Bell Atlantic's consultant concludes as follows:

[A]nnual revenue requirements for Bell Atlantic would not have materially changed if the omitted retirements estimated in the plant accounting audit had been posted in the activity years in which the plant was physically removed from service. It follows from this conclusion that a material bias was not created in the initial prices adopted under price cap regulation.<sup>141</sup>

Ameritech illustrates the lack of impact with simple examples that show there is no rate base or depreciation expense impact as a result of normal retirement activity.<sup>142</sup> And, BellSouth succinctly explains why there would be no impact either going into or under price cap regulation:

For initial prices, under the methods of accounting prescribed by the Commission in Part 32, the timing of the retirement of assets has no impact on the net investment used to set rates under rate of return regulation (which formed the basis for the initial price cap rates in 1990), and certainly has no impact on rates under price cap regulation (with or without sharing). This is so because when plant is retired, there are equal and offsetting entries to the telephone plant in service and accumulated depreciation accounts. "Net Plant," the amount used to establish the rate base under cost of service regulation is unchanged. Thus, even if it could be demonstrated that BellSouth failed to retire certain assets on a timely basis prior to price cap regulation, the initial price cap rates would be unchanged. The same holds true for the application of the "sharing mechanism" or the "lower formula adjustment," both vestiges of rate of return regulation, under price caps.<sup>143</sup>

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<sup>141</sup> Bell Atlantic Response, Exhibit 5, at 2.

<sup>142</sup> Ameritech Response at 12-13.

<sup>143</sup> BellSouth Response at 26 (footnote omitted).

Thus, omitted or delayed retirements would not have any impact under rate-of-return regulation prior to price caps or under the rate-of-return backstop mechanisms of price cap regulation, even assuming one could turn the clock back to those earlier periods to make a missed retirement. For example, as Bell Atlantic explains, the audit reports “shed[] no light on the amount of used and useful equipment in place almost a decade ago.”<sup>144</sup> Concluding that an item of equipment is missing now does not provide any basis for a conclusion as to its existence or verifiability in 1989, -- the base year for the initial price cap rates.<sup>145</sup> That would not be a rational or supportable inference.

Even though omitted or delayed retirements would not have any impact on the revenue requirements in the base year for rates going into price caps (i.e., 1989) even if we assume *arguendo* that there could be some impact – it would be inconsistent with the FCC’s price cap regime, and otherwise improper, to “re-initialize” an RBOC’s current price cap to the level it would have been absent the assumed impact.

While the FCC recognized that the 1990 rate-of-return rates were “perhaps not perfect,”<sup>146</sup> the FCC decided to take these rate-of-return rates as “a reasonable point of departure” as they “in general represent the best that rate of return regulation can produce.”<sup>147</sup> In fact, the FCC rejected requests by MCI and others that it conduct a

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<sup>144</sup> Bell Atlantic Response at 15-16.

<sup>145</sup> While the auditors attempted to make this type of inference by adding to the final December 1998 draft reports hypothetical figures under the discussion of the “Duration of the Problem,” those figures are pure speculation and are not supported by any evidence. See SBC LECs at 4-5 n.8 and Attachment B, at 3.

<sup>146</sup> *Policy and Rules Concerning Rates for Dominant Carriers*, CC Docket No. 87-313, NPRM, 2 FCC Rcd 5208 ¶232 (1987).

<sup>147</sup> *Id.* ¶56.

comprehensive rate case<sup>148</sup> as well as the LECs' calls for revisions on the ground that the rates were too low.<sup>149</sup> Therefore, to seek rate-of-return perfection long after the deadline for any challenges to 1990 rates is inconsistent with price cap regulation, and now more than ever given that the FCC has eliminated the low-end adjustment on a holding-company-wide basis for any price cap carrier that adopts any of the *Pricing Flexibility Order's* options in any of its markets. As simply stated by Bell Atlantic, "Having consciously decided that it would take the then existing rates as they were, warts and all, it is too late to revisit that decision today."<sup>150</sup>

If the FCC were going to begin considering reductions in those initial rates in pursuit of a more perfect rate-of-return based starting point – assuming it were proper and lawful to do so – the FCC would need to address other offsetting imperfections. For example, when price cap regulation was adopted near the end of 1990, SWBT submitted a mid-course correction to raise rates by over \$60 million. SWBT showed that the July 1990 rates going into price caps were unreasonably low based on actual cost data. However, the FCC rejected this mid-course correction for the sake of expediency in implementing price cap regulation.<sup>151</sup> The FCC reasoned "that a broad rate-of-return proceeding aimed at identifying possible deficiencies in existing rates prior to the commencement of the price cap rules would only serve to 'delay . . . the introduction of more economically efficient rates.'"<sup>152</sup> Thus, if the FCC were going to use the old rate-

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<sup>148</sup> *Policy and Rules Concerning Rates for Dominant Carriers*, CC Docket No. 87-313, *Second Report and Order*, 5 FCC Rcd 6816, ¶ 242 (1990).

<sup>149</sup> *Policy and Rules Concerning Rates for Dominant Carriers*, CC Docket No. 87-313, *Report and Order*, 4 FCC Rcd 2873, 3244, ¶ 768 n. 1600 (1989).

<sup>150</sup> Bell Atlantic Response at 16.

<sup>151</sup> *Southwestern Bell Tel. Co. v. FCC*, 10 F.3d 892 (1993).

<sup>152</sup> *Id.* at 897.

of-return “perfecting” process to reduce rates by reinitializing price caps based on these audits, then it would also need to review similar requests for increases in rates, such as SWBT’s mid-course corrections. However, it would be irrational and completely contrary to the entire concept of price caps to attempt to re-initialize price caps a decade into the new regime based on an audit, the likes of which the FCC never saw a reason to conduct when it was using rate-of-return regulation or when price caps were initialized in 1990.

For the same reasons that omitted or delayed retirements would not affect the rates going into price caps, it would be even more difficult for them to affect price cap rates in other respects such as through the sharing or low-end adjustment mechanism. That is, the retirement process would not have any impact on the interstate rate-of-return reported under price caps, and thus, could not have materially affected rates as a result of sharing or any low-end adjustment. And, even if there were some impact on such returns, it would be less likely to have an impact on the sharing and low-end mechanisms during the existence of those mechanisms. Use of the low-end mechanism was rare in the ten-year history of price cap regulation and the previous thresholds for sharing made it less likely that a rate adjustment would be triggered than under rate-of-return regulation. With the *Pricing Flexibility Order*’s effectively eliminating the low-end adjustment, there could be no prospective impact.

As BellSouth points out, USTA filed a paper in the Biennial Review proceeding on depreciation requirements which showed that “moderate changes in the depreciation rates have no impact on the productivity factor.”<sup>153</sup> Thus, omitted or delayed retirements which do not significantly affect depreciation rates over time, should not affect the productivity factor. Ameritech’s analysis of the impact on the productivity factor also confirms that ratepayers could not be harmed, even if one assumed material

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<sup>153</sup> BellSouth Response at 26, n. 69.

overstatement of plant balances.<sup>154</sup> In addition, the SBC LECs analyzed the impact of retirement on the FCC's productivity model using higher retirement levels in the past several years. There was no discernable difference in the resulting productivity factors.<sup>155</sup>

The NOI also inquires about the impact on Part 64 cost allocation and Part 36 separations, but the audits do not say anything about how the audited equipment is allocated or separated under these rules. Thus, the SBC LECs see no basis to even contend that there could be any impact on this allocation or separation of costs, much less any impact that would be pertinent to rates under price cap regulation. In any event, consistent with Ameritech's analysis, the cost-causative linkage between the SBC LECs' central office investment and any allocation to nonregulated activities in their Cost Allocation Manuals is *de minimis*.<sup>156</sup>

In summary, the SBC LECs submit that the alleged inaccuracies in the CPRs would not have any adverse impact on ratepayers of the RBOCs even if there were as many missing items of equipment as the audit reports allege.

**B. Net Plant Balances Are Not Affected by Normal Retirements.**

Even the Bureau appears to acknowledge that the impact of a delayed retirement would be minimal. However, the Bureau's admission appears to be limited to "recent" retirements. In a letter responding to questions from Congress about these audits, the Bureau states:

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<sup>154</sup> Ameritech Response at 15.

<sup>155</sup> The SBC LECs do not see how retirements could have any impact on an exogenous cost adjustment, although it is difficult to analyze the impact on this mechanism without knowing the nature of the exogenous cost involved.

<sup>156</sup> Ameritech Response at 17.

[1] The plant was properly capitalized and recently taken out of service but not retired from the books. Under this first scenario, the accounting error would be minimal, due to the carrier delaying, for a short period of time, their reporting of the retirement on its CPR. The most likely corrective accounting treatment would be a standard retirement, which would include a reduction from the reserve equal to the amount retired.<sup>157</sup>

In effect, the Bureau admits that these delayed retirements would not have any impact on the net plant balances. The SBC LECs submit that this is the only appropriate method of handling a delayed or omitted retirement.

In this letter, the Bureau describes two other methods of handling the retirement of equipment that could not be found during the audit: an extraordinary retirement and a full write-off. It is important to understand that none of these three methods described by the Bureau is appropriate for an extrapolated figure. That is, as Ameritech, Bell Atlantic and BellSouth have already explained in their responses, assets cannot be retired consistent with the rules without identifying all of the individual units being retired.<sup>158</sup> Estimates based on statistical analysis will not produce unit-specific data needed for a retirement.<sup>159</sup>

However, as applied to individually identifiable units that cannot be found during a physical verification of assets, such as the "not found" items in the auditors' sample, these should be handled, as stated by the Bureau in the above-quoted language, as normal retirements that have no impact on net plant. The other two methods described in the Bureau's response are not appropriate under the circumstances of this audit. Among other reasons, the auditors did not perform any procedures to test the controls that assure that

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<sup>157</sup> Feb. 24, 1999 FCC Letter to Congressmen Tauzin and Dingell at 5.

<sup>158</sup> See Ameritech Response at 17; Bell Atlantic Response at 23-24; BellSouth Response at 32 n.77; SBC LECs Response at 7.

<sup>159</sup> For further discussion of the problems with a write-off or retirement of an extrapolated figure, see Issue 4 above.

assets are properly placed on the books. While the audit reports allege that items could not be found at the time of the field audits, they do not contend that assets never existed, nor did the auditors perform any procedures to be able to reach such a conclusion, even if the auditors had wanted to do so. Further, the SBC LECs agree with Bell Atlantic that these items do not satisfy the criteria for an extraordinary retirement,<sup>160</sup> nor would a full write-off be proper, as previously discussed, especially when one considers that the magnitude of the discrepancies is much smaller than the audit reports allege.<sup>161</sup>

Extraordinary retirements typically involve an extraordinary loss that is not covered by insurance, such as when a significant share of a utility's assets is destroyed by fire or some other calamity. In such cases, the utility would be allowed to amortize the extraordinary retirement over a period of years, which is less than the remaining life of the destroyed plant.<sup>162</sup> The nature of these catastrophic events must be such that they are not normally taken into account in setting depreciation rates. However, these audits do not present such a situation for which the extraordinary retirement rule was designed.<sup>163</sup>

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<sup>160</sup> Bell Atlantic Response at 23 & Exhibit 5 at 1-2, 7-8.

<sup>161</sup> In any event, the FCC has not identified any rule that would permit a full write-off under these circumstances. As Bell Atlantic points out, the only reference to write-offs in the current rules is for excessive cost of plant acquired from other carriers under 47 C.F.R. §§32.2005 & 32.6565.

<sup>162</sup> See NARUC, Public Utility Depreciation Practices 205-07 (1968; May 1974 reprint).

<sup>163</sup> The historical precedents of the current extraordinary retirement rule show its intended purpose, including recovery of the loss over a period of time. *Cf.* 47 C.F.R. § 31.02-83 (1986) ("If the cause of retirement is not a recognized factor in depreciation and the loss is not covered by insurance, the company may upon proof that the charge to the depreciation reserve will result in undue depletion thereof, and with the approval of the Commission, credit account 171, "Depreciation reserve," and charge account 138, "Extraordinary maintenance and retirements," with the unprovided-for loss in service



And, these audits do not satisfy the requirements for an extraordinary requirement in Section 32.2000(g)(4):

- (A) The impending retirement was not adequately considered in setting past depreciation rates.
- (B) The charging of the retirement against the reserve will unduly deplete that reserve.
- (C) The retirement is unusual such that similar retirements are not likely to recur in the future.

Starting with the last of these requirements, delayed or omitted retirements are not unusual, as explained in Bell Atlantic's Response.<sup>164</sup> In fact, utilities periodically perform physical inventories to discover and correct these and other discrepancies in their property records. As some of the RBOCs explain, they routinely perform inventories on a rotating basis over a period of years.<sup>165</sup> It is common to expect each of these inventories to produce a number of inventory adjustments and retirements.<sup>166</sup> Therefore, retirements

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value and distribute it from that account to account 609, "Extraordinary retirements," over such period as this Commission may approve."); Interstate Commerce Commission, Uniform System of Accounts for Telephone Companies, adopted Dec. 10, 1912, at 68, Instruction No. 68 ("Extraordinary casualties and unanticipated reconstruction.—If so authorized, . . . the company . . . may charge the amount named in the authorization to a suspense account for the purpose of distributing over a limited period an extraordinary loss of such a nature that it can not be anticipated by the exercise of reasonable prudence. Losses of this sort may be due to the requirement by lawful authority or public necessity of improvements involving the abandonment of a considerable portion of plant . . . before it has attained its normal life in service, or to an extraordinary casualty entirely unforeseen and unprovided for.").

<sup>164</sup> Bell Atlantic Response, Exhibit 5, at 1-2, 7-8.

<sup>165</sup> BellSouth at 30-31; Bell Atlantic at 24.

<sup>166</sup> In fact, the FCC auditors have requested and obtained information concerning some of the SBC LECs' inventories and are aware of the adjustments and retirements that such

produced by physical inventories are not unusual. Simply, routine correction of retirement records is not the type of extraordinary event for which the extraordinary retirement rule was intended.

Besides, the first criterion is not satisfied either. Among other reasons, one cannot say that these types of retirements are not adequately considered – to the extent that the three-way meeting negotiation process relies directly on detailed retirement data. Periodic inventories are commonplace and the inventory adjustments resulting from them are likewise commonplace. Thus, inventory adjustments of this nature are reflected in the data presented in past depreciation studies. However, retirements are not the only factor used in establishing depreciation rates. Accordingly, a difference in the level of retirements would not necessarily result in a change in depreciation rates. If delayed retirements had been processed in a timely fashion, they would not have caused any material changes in the depreciation studies that were filed and it is extremely unlikely that they would have altered any of the results of the give-and-take of the negotiation process that occurs during three-way meetings.

In any event, even assuming that the other two criteria could be satisfied and that the “not found” investment were as large as the audit reports allege (which it is not),

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periodic inventories produce. For example, in response to data requests in the 1994 audit, Pacific Bell described its physical inventory procedures for central office investment. Likewise, in 1995, SWBT informed the Bureau of the types of physical inventories that it intended to perform from 1995 to 1997. In 1997, the Bureau asked SWBT for a list of the central office physical inventories performed from 1993 to 1996. Likewise, the GTE audit report released in 1998 reflects the FCC’s knowledge of inventory adjustments made by GTE in connection with its physical inventories. *GTE Telephone Operating Companies; Release of Information Obtained During Joint Audit*, 13 FCC Rcd 9179 Audit Report, GTE Response at 6, 9 (1998). Even much earlier, AT&T’s Comptroller’s M-Letters regarding the CPRs described the companies’ periodic inventory programs.

considering an RBOC's large depreciation reserves, there would not be a significant impact on any of these reserves, and they certainly would not be unduly depleted. For example, as part of the SAVR process, SWBT has been performing inventories of its central offices, and yet, the annual retirements that this process has produced have only resulted in minor reductions in the depreciation reserve in the applicable switching and circuit accounts.

**IX. Embedded Account Balances Are Largely, if Not Completely, Irrelevant to the Determination of Hypothetical Forward-Looking Economic Costs for Universal Service Support and UNE Prices (Issue 9).**

Under the federal models, universal service support and unbundled network element ("UNE") prices are based on forward-looking costs of a hypothetical network using the least-cost, most efficient technology available.<sup>167</sup> The forward-looking methods of making these calculations generally do not rely on the ILEC's actual, embedded cost data recorded in its regulated books of account. In fact, the FCC has rejected the use of actual, embedded costs in calculating these figures under the 1996 Act.<sup>168</sup> Accordingly, there is no reason to expect a causal relationship between inaccurate account balances and the results of these forward-looking cost models.

The FCC is still in the process of finalizing the cost model for universal service support, but the FCC's forward-looking model platform does not rely on an individual

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<sup>167</sup> *Federal-State Joint Board on Universal Service*, 12 FCC Rcd 8776 (1997).

<sup>168</sup> *Federal-State Joint Board on Universal Service, Forward-Looking Mechanism for High Cost Support for Non-Rural LECs*, CC Docket No. 97-160, *Fifth Report and Order*, 13 FCC Rcd 21323 ¶10 (1998); *Implementation of the Local Competition Provisions in the Telecommunications Act of 1996*, 11 FCC Rcd 15499, ¶¶ 621, 673, 704-707 (1996).

carrier's cost of equipment or labor in the calculation.<sup>169</sup> While the model platform relies to a limited extent on industry-wide book expense to investment ratios, adjustment of an individual carrier's account balances is irrelevant in the current model. The very nature of a forward-looking economic cost excludes the carrier's embedded or historical costs. That is, the FCC's model focuses on designing the network to use the latest, most efficient loop and switch technologies, not those actually in use by any carrier. In fact, the hypothetical costs are not those of an individual carrier or even those of the average carrier, but instead, those of the most efficient carrier using the latest technology, calculated on a purely forward-looking basis.

Similarly, Ameritech demonstrates why forward-looking, economic UNE prices are largely unaffected by any changes in account balances.<sup>170</sup> The causal connection is very weak or non-existent because UNE cost studies "reflect only incremental, forward-looking, state-of-the-art technology and exclude costs that cannot be directly attributed to a particular service . . . ."<sup>171</sup> Account balances are not used to determine the carrier's investment. Thus, changes in account balances do not affect the level of investment included in the UNE calculation. While these cost studies are not generally affected by book costs, consistent with the SBC LECs' experience, Ameritech accurately identifies two factors in its studies where there is a causal connection: the maintenance factor and

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<sup>169</sup> See *Federal-State Joint Board on Universal Service, Forward-Looking Mechanism for High Cost Support for Non-Rural LECs*, CC Docket No. 97-160, *Further Notice of Proposed Rulemaking*, FCC 99-120, released May 28, 1999, ¶¶ 20-22, 50, 72, 89, 162, 171-173, 198-200, 203-208, 233-234 & Appendix A.

<sup>170</sup> Ameritech Response at 15-16.

<sup>171</sup> *Id.* at 15.

the ad valorem tax factor.<sup>172</sup> However, if account balances have been overstated, as the FCC auditors allege, these cost factors and UNE prices have been lower than they would have been otherwise. Consequently, if account balances were reduced, as recommended in the audit reports, the result would be to increase these factors, and thus, there would be moderate increases in future UNE prices.<sup>173</sup>

Accordingly, even if account balances had been materially overstated, as alleged in the audit reports, such alleged overstatements would not have caused universal service support or UNE prices to be higher.

**X. Significant Retirements May Increase the RBOCs' Depreciation Reserve Deficiencies (Issue 9(b)(2)).**

The FCC has recognized the need to address the recovery of historical or embedded costs, that is, according to the FCC, "whether and to what extent carriers should receive compensation for the recovery of allocated costs of past investments if competitive market conditions prevent them from recovering such costs . . .".<sup>174</sup> As the FCC has acknowledged, some of this under-recovery "may be traced to past regulatory practices"<sup>175</sup> such as the FCC's regulation of depreciation rates which established unreasonably long depreciation lives.<sup>176</sup> In the Access Reform Proceeding, in 1996, the

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<sup>172</sup> *Id.* at 16.

<sup>173</sup> *Id.*

<sup>174</sup> *Access Charge Reform; Price Cap Performance Review for Local Exchange Carriers; Transport Rate Restructure and Pricing; End User Common Line Charges*, 12 FCC Rcd 10175 n.25 (1997).

<sup>175</sup> *Access Charge Reform; Price Cap Performance Review for Local Exchange Carriers; Transport Rate Structure and Pricing and Usage of the Public Switched Network by Information Service and Internet Access Providers*, 11 FCC Rcd 21354 ¶ 249 (1996).

<sup>176</sup> *Id.* ¶¶ 266-270.

FCC asked ILECs to quantify their depreciation reserve deficiencies.<sup>177</sup> As an example of the responses the FCC received, SWBT calculated, using the procedures in the FCC's depreciation study guide, a conservative, low-end figure of \$1.8 billion for its depreciation reserve deficiency (on an unseparated basis).<sup>178</sup> While this figure underestimated the true amount of the depreciation reserve deficiency at that time,<sup>179</sup> it represented the minimum amount of depreciation catch-up recovery as of 1996. The NOI asks what impact the alleged discrepancies in the CPR would have on cost recoveries of this type.

Given that the size of the discrepancies is much smaller than the audit reports allege, there should not be much, if any, change in the depreciation reserve deficiency, especially after one considers other factors affecting that deficiency over time. However, if the quantity of resulting retirements were material and if the retired assets have not been fully depreciated, then the amount of this depreciation reserve deficiency would increase because of the way it is calculated using the procedures in the FCC's depreciation study guide. The depreciation reserve deficiency is the difference between the book reserve and the theoretical reserve. Under the FCC's method of calculating this reserve deficiency, while the entire cost of the retired assets is removed from the book reserve, that cost is only removed from the theoretical reserve to the extent that the asset has been depreciated at the time of the retirement. Thus, retirements prior to fully

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<sup>177</sup> *Id.*

<sup>178</sup> Comments of Southwestern Bell Telephone Company, CC Docket No. 96-262, filed January 29, 1997, at 56-58 & Appendix 2. In its calculation of the \$1.8 billion reserve deficiency, SWBT did use appropriate economic lives and net salvage parameters for each asset category consistent with SWBT's external financial reporting.

<sup>179</sup> *Cf.* Comments of Southwestern Bell Telephone Company, Pacific Bell and Nevada Bell, CC Docket No. 98-137, filed November 23, 1998, at 25 n.67 (providing an economic theoretical reserve deficiency of \$3,987 million as of 1997).

depreciating assets would increase the difference between the book reserve and the theoretical reserve, and thus lead to a larger reserve deficiency. Other methods of calculating the depreciation reserve deficiency may avoid this impact.

**XI. The FCC Should Consider this Audit in a Broader Context than the Auditors (Issue 10).**

In Issue 10, the FCC recognizes that these audits need to be considered in a broader context that takes into account factors such as whether the auditors used a reasonable interpretation of the rules, whether the FCC has consistently applied these requirements, whether these requirements serve any useful purpose, whether they are consistent with other statutory and regulatory policies such as the cost benefit analysis required by Section 11 of the 1996 Act, and how they compare to the asset tracking activities of other state and federal governmental agencies such as the Federal Energy Regulatory Commission ("FERC") and the General Accounting Office ("GAO") and to the standards of GAAP required for Securities and Exchange Commission ("SEC") reporting purposes.<sup>180</sup> Many aspects of these broader issues are the subjects of intense debate in various Biennial Review proceedings.<sup>181</sup> The FCC can simply take administrative notice of the record in those proceedings and the many doubts that parties have raised regarding the validity of the original purpose of the relics of rate-of-return regulation, including the property record requirements. As price cap regulation has evolved, the FCC has endeavored to make rates less and less reliant on costs and accounting records. As discussed under Issue 8 above, the FCC has succeeded in

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<sup>180</sup> NOI at 4.

<sup>181</sup> See, e.g., Arthur Anderson Whitepaper; "Supplement to July 15, 1998 Position Paper: Accounting Simplification in the Telecommunications Industry", at 11, filed with Letter dated November 10, 1998 from Mr. Carl R. Geppert, Arthur Andersen LLP to Ms. Magalie Salas, FCC ("Arthur Andersen Whitepaper Supplement").

disconnecting costs and rates to the point that the audits are not material to the price cap rate setting process. The FCC has recognized the reduced value of these requirements under price caps, and yet, its auditors began the first such comprehensive CPR audits eight years after adopting price cap regulation.

These audits were performed in a manner that unduly intensified the burden of the CPR requirements, considering their limited value. According to the rules, the CPR is supposed to include the “specific location of the property within each accounting area.”<sup>182</sup> The accounting area is generally an entire state or group of states.<sup>183</sup> A central office is a “specific location” in the state. The rules do not include a definition of “location” or “specific location.” Thus, by interpreting the rules to require the RBOCs to identify exactly which central office bay or frame contains an item, the auditors have applied an overly strict and narrow interpretation of the CPR requirements.<sup>184</sup> While the PICS/DCPR system generally identifies the floor and bay location as well as the continuing property record number, the rules do not specifically require that all of these details be included in the CPR. It should be sufficient if the CPR identifies the central office location. Thus, if an item was found anywhere within the central office, it cannot properly be deemed “not found,” even if the details in the CPR do not match exactly what the auditors observed or exactly what is stated on a supporting invoice. Further, immutable conclusions reached by the auditors during their limited one-time field visits is another form of interpretative narrowing of the CPRs to include data that is not stated in

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<sup>182</sup> 47 C.F.R. § 32.2000(f)(5).

<sup>183</sup> See, e.g., *In the Matter of GTE Telephone Operating Companies; Release of Information Obtained During Joint Audit*, 13 FCC Rcd 9179, Audit Report, GTE Response at 12 (1998).

<sup>184</sup> See also GTE’s Motion for a Declaratory Ruling on Asset Verification, filed May 13, 1998.



the rules. According to the auditors, the company has a limited window of ten to twenty minutes to find each randomly selected item and present convincing evidence that it is truly the same as the item listed in the CPR. All of the auditors efforts after-the-fact cannot change the fact that they reached their conclusions during or shortly after the field visits and did not seriously consider any, but the most compelling, of the RBOCs' post-field audit submissions. These audit procedures involved unprecedented interpretations of the rules and how they are to be applied generally to the industry, which interpretations the auditors did not have authority to adopt.

Moreover, increasing the burden of these regulations at this time via comprehensive audits and unprecedented interpretations by the auditors does not make sense long after abandonment of rate-of-return regulation. Further, it is inconsistent with the requirement that the FCC eliminate unnecessary regulation because the FCC does not need such detailed property records to perform its regulatory functions and it certainly does not need to interpret its requirements in such an onerous, one-sided fashion to carry out any of its responsibilities.

The CPR requirements were adopted and enhanced during the rate-of-return era, but now is the time to relax them. When a federal uniform system of accounts ("USOA") was first adopted for telephone companies in 1913, there were no property record requirements.<sup>185</sup> That USOA provided that the "amount charged as expense of depreciation should be based upon rules determined by the accounting company."<sup>186</sup> After the FCC took over the USOA, it required LECs to begin preparing a CPR in 1937

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<sup>185</sup> Interstate Commerce Commission, Uniform System of Accounts for Telephone Companies, adopted Dec. 10, 1912.

<sup>186</sup> *Id.* § 23 ("Depreciation of plant and equipment.")

and initially required it to be completed by mid-year 1939.<sup>187</sup> This completion date subsequently slipped to mid-year 1946.<sup>188</sup> While the very general CPR requirement had been adopted in 1930s, specific guidelines were not added until 1943.<sup>189</sup> As of 1943, the guidelines required the CPR to “reveal the essential details of construction and the cost of each building, each central office in each building and each large [PBX].”<sup>190</sup> The entire central office was the “property record unit.” While underlying records had to be maintained to enable the company to make a “reasonably accurate estimate” of the cost of individual “retirement units” within the central office “property record unit,” a detailed CPR was not yet required. By 1953, the FCC had added a requirement that, in some cases, the cost of the central office property record unit be broken down into the individual retirement units of which it was composed.<sup>191</sup> Finally, with the advent of computerized records, AT&T submitted plans for a detailed mechanized CPR in the mid-1960s which was formally approved as to hardwire equipment in the December 1968 ruling, as explained in more detail in the SBC LECs’ Response.<sup>192</sup> This chronology shows how the FCC gradually increased the level of detail required in the CPR over the years during which it exercised regulatory oversight over the RBOCs’ rates using a cost-based, rate-of-return method that increasingly focused on more detailed accounting data.

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<sup>187</sup> 47 C.F.R. § 31.2-26 (1938).

<sup>188</sup> 47 C.F.R. § 31.2-26 (1949).

<sup>189</sup> *Id.* Appendix B, ¶10.

<sup>190</sup> *Id.* Appendix B, ¶2(c).

<sup>191</sup> 47 C.F.R. Part 31, Appendix B, ¶2(d)(1953).

<sup>192</sup> *See* SBC LECs Response at 34-38.

With these CPR audits, the auditors are continuing in the same direction by proposing to apply even stricter CPR requirements, despite the fact that the FCC changed directions ten years ago, when it began to reduce its reliance on detailed accounting data and that the FCC practically reaches its “no-reliance-on-accounting-data” destination in the *Pricing Flexibility Order*.

Recent developments at the FERC are instructive in this area. In a recently concluded rulemaking, the FERC recognized that

[T]he level of detail prescribed by the current property unit listings and regulations place an unnecessary burden on Companies, are not current, are too restrictive, and appear to provide minimal benefit to either the Companies or to the Commission.<sup>193</sup>

Accordingly, the FERC

concluded that eliminating the property unit listings and regulations would give Companies the flexibility to maintain their own property listings and track the costs of fixed assets at the level of detail tailored to their business. This in turn would reduce the burden Companies experience when tracking fixed assets at a level more detailed than either their business or the Commission needs, and also eliminate the burden placed on the Commission to update the items in the listings to take account of technological advances and items of property that are no longer used by Companies.<sup>194</sup>

While the companies still have to maintain a property recordkeeping system, the FERC permitted them to define their own property record units without having to seek any approval or make any filing with FERC. Thus, the FERC-regulated utilities are permitted to maintain their property records at a higher level than the individual retirement units if they so choose. Ironically, the FERC has simplified its CPR requirements even though it

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<sup>193</sup> Units of Property Accounting Regulations, 63 Fed. Reg. 6847 (Feb. 11, 1998).

<sup>194</sup> *Id.*

continues to use a rate-of-return approach in its rate-making proceedings.<sup>195</sup> In contrast, the FCC has abandoned rate-of-return regulation but continues to maintain overly burdensome and detailed property record requirements, despite the deregulatory mandates of the 1996 Act.

As the discussion above and under Issue 8 demonstrates, there is little, if any, benefit and significant costs in continuing to require excessively detailed CPRs. Even assuming that requiring a CPR has some valid regulatory purpose, the currently required level of detail is far more than could be reasonably necessary. ILECs should be allowed to combine two or more retirement units in the manner allowed by the FERC, i.e., without the necessity of the agency's prior approval. In fact, in the not-so-distant future, the FCC should consider relying solely on the requirements of GAAP so that ILECs are not placed at a disadvantage compared to their competitors who are not subject to such onerous, costly requirements.

GAAP provides a sufficient safeguard for SEC purposes and it should also be sufficient for FCC purposes, in view of the minimal practical utility of these CPR requirements. Property records are useful as part of the internal controls necessary to safeguard assets and ensure that financial statements and account balances are accurately stated, but there is no added value in requiring more detail than what is necessary to satisfy GAAP and the needs of the business to manage assets efficiently.<sup>196</sup> While GAAP is generally silent as to precisely which mechanisms are necessary to assure accurate financial reporting of asset account balances, it does require adequate internal controls designed to satisfy the concepts of GAAP, such as representational faithfulness, which

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<sup>195</sup> *Maine Public Serv. Co.*, 85 F.E.R.C. 61,412 (1998); *South Carolina Elec. & Gas Co.*, 76 F.E.R.C. 61,338 (1996).

<sup>196</sup> In addition, the Foreign Corrupt Practices Act requires publicly held companies to have adequate internal accounting controls over all assets. *See* 15 U.S.C. § 78m.

refers to the correspondence or agreement between the accounting numbers and the resources or events those numbers purport to represent.

The NOI inquires “what other federal and state agencies do . . . to ensure the accuracy of books and records.”<sup>197</sup> Aside from the recent developments at the FERC, the experience of the federal government itself provides an interesting contrast to the FCC auditors’ activity. In the 1997 Consolidated Financial Statement for the United States Government, the GAO describes the following “material deficiency” in the government’s recordkeeping:

Hundreds of billions of dollars of the more than \$1.2 trillion of these reported assets are not adequately supported by financial and/or logistical records. . . .

Because the government does not have complete and reliable information to support its asset holdings, it could not satisfactorily verify the existence of all reported assets, substantiate the amounts at which they were valued, or determine whether all of its assets were included in its financial statements. . . . These problems impair the government’s ability to (1) know the location and condition of all its assets, including those used for military deployment, (2) safeguard them from physical deterioration, theft, or loss, (3) prevent unnecessary storage and maintenance costs or purchase of assets already on hand, and (4) determine the full costs of government programs that use the assets.<sup>198</sup>

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<sup>197</sup> NOI at 4.

<sup>198</sup> GAO, Report to the Congress, Financial Audit: 1997 Consolidated Financial Statements of the United States Government at 16-17 (Mar. 1998)(emphasis added). *Accord*, GAO, Report to the Congress, Financial Audit: 1998 Financial Report of the United States Government at 19, 23 (Mar. 1999) (“Major problems included the federal government’s inability to . . . properly account for and report . . . billions of dollars of property, equipment, materials, and supplies. . . . The federal government . . . does not have adequate systems and controls to ensure the accuracy of information about the amount of assets held . . . . A majority of the \$466 billion of these reported assets is not adequately supported by financial and/or logistical records. . . . Also, the government cannot ensure that all assets are reported. . . . [P]eriodic physical counts have shown that property records contain significant error rates.”).

The SBC LECs are not suggesting that the Government should spend excessive amounts of taxpayer money to create onerous property recordkeeping systems like those that apply to LECs or to otherwise adopt overly stringent controls over assets. However, it is ironic that the RBOCs are being held to such high, intricately detailed CPR standards when the government itself cannot satisfy the basic requirements of the applicable accounting principles.<sup>199</sup> At a minimum, the same sort of cost benefit approach that is applied on a national scale or by other federal agencies should be generally instructive for the FCC's approach to the private sector.

### **Conclusion**

For the foregoing reasons, the FCC should reject the audit results as unsound and unreliable. The audits were not designed or performed in a manner that could enable the auditors to achieve their objectives. The serious deficiencies in the sample design and the auditors' procedures prevent the audits from serving as the basis for any corrective action. The auditors' three recommendations – for write-offs, complete physical inventories and independent reviews of internal controls – are not justified by the flawed audit results. Even if these significant flaws could be corrected after the fact, the recommendations would not be justified when one applies a cost/benefit analysis. In fact, these recommendations are contrary to the rules and the record in several respects. Besides, the auditors have ignored significant information presented by the RBOCs in reaching their conclusions, including most importantly, their rejection, without explanation or further investigation, of the RBOCs' proof of the existence of dozens of the items scored as "not found." In any event, even assuming the validity of some of the audit results, they should not play any role in the performance of any of the FCC's regulatory functions, such as ratemaking, universal service support calculations or UNE

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<sup>199</sup> The federal government's financial statements are governed by the Statements of Federal Financial Accounting Standards ("SFFAS").

pricing. Instead of taking any action, such as that recommended by the auditors, based on these audits, the FCC should consider methods of streamlining and updating the FCC's asset tracking requirements to require no more than what is reasonably necessary.

Respectfully submitted,

SOUTHWESTERN BELL TELEPHONE COMPANY  
PACIFIC BELL  
NEVADA BELL

By: Jonathan W. Royston  
Alfred G. Richter, Jr.  
Roger K. Toppins  
Jonathan W. Royston  
One Bell Plaza, Room 3005  
Dallas, Texas 75202  
214-464-5534

Attorneys for SBC Communications Inc.  
and its Subsidiaries

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